

**STATE BOARD OF EQUALIZATION**

To: Mr. Robert M. Stock  
Senior Tax Auditor

Date: July 1, 1996

From: Kelly W. Ching  
Tax Counsel

Subject:

This is in response to your request dated April 19, 1996 regarding the application of tax to certain transactions involving the sale and lease of mobile transportation equipment (MTE).

You indicate that --- --- --- sent you an inquiry dated February 6, 1996, in which it states that currently, it charges and reports tax on rental receipts. In the February 6, 1996 letter and in another letter dated April 9, 1996, the taxpayer's representative states as follows:

"This office represents --- --- --- which leases trucks only. It charges and pays to the state sales or use taxes on such rentals.

“ --- --- --- proposes to:

- "1. Sell at its book value all of its trucks to another 'Dealer.'
- "2. Purchase back said trucks at book value and pay sales tax [reimbursement] on the full purchase price to the transferor.
- "3. Lease the trucks to various, lessees ... in the same form as when re-acquired.
- "4. --- --- will not charge sales or use tax on truck rental charges or receipts since it will have paid sales tax [reimbursement] on the full purchase price for said trucks.

"Query:

"Based upon the foregoing set of assumed facts, will --- --- --- be acting properly under Regulation 1660, in [particular], section (c) 'General Application of Tax,' subsection (3) 'Property purchased, tax paid' in not charging sales or use tax on truck lease/rental charges and/or receipts."

In response to a letter from you requesting more information, the taxpayer indicated that --- --- --- trucks are considered MTE, that --- --- --- originally purchased the trucks under resale certificates from out of state vendors, and that there is no business relationship between --- --- --- and the dealer to whom --- --- --- will sell (and from whom it will repurchase) its trucks. The taxpayer stated that the proposed sale price is \$385,800, that the current book value is also \$385,800, but that ---'s cost of its inventory of trucks it plans to sell and repurchase is \$1,863,308.

We assume that --- --- --- leases are true leases and not sales at inception. (See Reg. 1660(a)(2)(A).) The taxpayer has asked how tax applies under Regulation 1660. As you know, since the property --- --- --- will lease constitutes MTE, Regulation 1661, rather than Regulation 1660, applies. This means that the provision the taxpayer discussed in its inquiry, subdivision (c)(3) of Regulation 1660 entitled "Property Purchased Tax Paid," is not applicable to the taxpayer's situation.

A lease of MTE is excluded from the definition of "sale" and "purchase" for purposes of the Sales and Use Tax Law. (Rev. & Tax. Code §§ 6006(g)(4), 6010(e)(4).) The sale of MTE to a person who will lease it is the retail sale; therefore, the sale to the lessor, or the use by the lessor (by leasing), is subject to sales or use tax. (Rev. & Tax. Code §§ 6051, 6201.) Our understanding is that the dealer's sale to --- --- --- will take place inside California; therefore, the applicable tax will be sales tax. --- --- --- the lessor, will be the consumer of the MTE it leases.

With respect to the MTE that is leased, if the use of the MTE will be limited to leasing and the lessor makes a timely election to do so, the lessor may pay its tax liability measured by the fair rental value of the MTE, meaning the amount of rentals required by the lease, if the election is made on or before the due date of a return for the period in which the equipment is first leased. (Reg. 1661 (b)(2).) The election must be made by reporting tax measured by the fair rental value on a timely return for that period. (Id.) Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the equipment is within or without this state. (Id.) The election may not be revoked with respect to the equipment as to which it is made. (Id.) Therefore, the election to pay tax measured by fair rental value is irrevocable if there is no sale of the MTE. (BTLG Ann. 335.0084 (5/5/93).) This is because the tax fully accrued at the time of the sale, and by making the election, the

lessor simply chose to spread out its already-accrued tax liability rather than paying it in full at the time of the sale.

If, in connection with an assignment of an existing lease of MTE, title to the leased property is transferred to an assignee and we consider the transfer to be a legitimate sale for sales and use tax purposes, the purchaser/assignee will be the consumer of the equipment, and, just as the original lessor could, the purchaser/assignee may issue a resale certificate and elect to pay tax on the fair rental value with respect to its leases. (Regulation 1661(b)(2).) As with any such election, the election must be made on a timely filed return for the period in which the sale occurred, and is irrevocable.

The taxpayer states that it is not related to the dealer, and provides information regarding the book value and the proposed sales price of the trucks, but does not provide information regarding the fair market value of the trucks. It appears that after the sale by --- --- ---, the dealer and the subsequent sale back to --- --- --- take place, --- --- --- will continue to lease the equipment. After the two sales take place, nothing will have changed other than that tax will be reported and paid on the purchase price, rather than being reported and paid on the rental receipts. It appears that the dealer will not even be compensated for acting as the "straw man" in the proposed transaction. Transfers without a purpose or effect other than to change the way tax is reported and paid are disregarded for sales and use tax purposes. (Cf. Business Taxes Law Guide Annotations 330.1875 (7/8/92), 330.2820 (3/30/90), 330.5200 (8/14/69). )

It is clear that the proposed transaction has no purpose other than to change the way --- reports tax. If it also has no other effect, it will be disregarded for sales and use tax purposes, and --- --- will continue to be required to report tax on fair rental value.

We will regard the transaction as having an effect other than the mere changing of --- --- ; method of reporting tax if the transaction is structured as if at arms length. --- --- --- sale to the dealer will be regarded as structured as if at arms length if the price to the dealer is set at an amount for which a person selling an inventory of MTE subject to leases would sell that inventory to an unrelated person.

Similarly, we will regard the dealer's sale back to --- --- --- to be structured as if at arms length only if the sale price is for an amount for which a dealer would resell such inventory subject to leases to an unrelated purchaser. That is, the dealer's sales price to --- --- --- must be the fair retail selling price .. book value has no relevance to whether the dealer's selling price is at fair retail value. In addition, under these facts, if the dealer resells the MTE to --- --- --- for the exact price it pays, the transaction will most likely be disregarded since it is not a transaction structured as if at arms length. The dealer would have direct costs of entering into the transaction, and would also have overhead expenses allocable to the transaction. Thus, to

be regarded as an arms length transaction, the selling price to --- --- --- must be for fair retail value, and cannot be less than the price paid by the dealer plus its costs of business related to the purchase and resale. In addition, the transaction will not be recognized for sales and use tax purposes if: --- --- and the dealer do not file all necessary DMV documents that would be required for any true sale to a dealer and true resale by that dealer, and if they do not pay all applicable fees on such transfers.

If the transactions are recognized for sales and use tax purposes as discussed above, --- will be treated as any other lessor purchasing MTE for leasing purposes. (Reg. 1661 (b)( 1).) If such is the case, --- --- --- may pay sales tax reimbursement to the dealer when purchasing the MTE, and would not be required to pay tax on fair rental value.

If you have further questions, please feel free to write again.

KWC:cl

cc: Mr. Dennis Fox, Program Planning Manager (MIC:92)